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BEFORE THE
DEPARTMENT OF TRANSPORTATION
WASHINGTON, D.C.

Joint Application of	:	
	:	
American Airlines, Inc. and	:	
Executive Airlines, Inc., Flagship	:	
Airlines, Inc., Simmons Airlines,	:	
Inc., and Wings West Airlines, Inc.	:	
(d/b/a American Eagle)	:	
and	:	**Docket OST-95-792** -17
Canadian Airlines International Ltd.	:	
and Ontario Express Ltd. and Time Air	:	
Inc. (d/b/a Canadian Regional) and	:	
Inter-Canadian (1991) Inc.	:	
	:	
under 49 USC §§ 41308 and 41309 for	:	
approval of and antitrust immunity for	:	
commercial alliance agreement	:	
	:	

ANSWER OF AIR CANADA

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Dated: February 6, 1996

BEFORE THE
DEPARTMENT OF TRANSPORTATION
WASHINGTON, D.C.

Joint Application of **American Airlines, Inc. and Executive Airlines, Inc., Flagship Airlines, Inc., Simmons Airlines, Inc., and Wings West Airlines, Inc. (d/b/a American Eagle)** **and** **Canadian Airlines International Ltd. and Ontario Express Ltd. and Time Air Inc. (d/b/a Canadian Regional) and Inter-Canadian (1991) Inc.** **under 49 USC §§ 41308 and 41309 for approval of and antitrust immunity for commercial alliance agreement**	:	**Docket OST-95-792**

ANSWER OF AIR CANADA

American Airlines ("American") and Canadian Airlines International ("Canadian"), and their respective affiliates (collectively referred to as the "Joint Applicants") have requested that the Department of Transportation ("DOT" or "Department") approve and confer antitrust immunity upon their Commercial Alliance Agreement, which, if implemented, would enable the carriers to integrate their commercial activities and to operate as if they were a single carrier. Although the Joint Applicants assert that their arrangement would be both consistent with settled U.S. policy and procompetitive, the facts suggest otherwise.

The basic arguments advanced by the Joint Applicants are that the American/Canadian alliance must be treated in the same manner as the alliance between Northwest and KLM, and that, without a grant of antitrust immunity, the Joint Applicants would be hindered from competing fully in the transborder market. The Joint Applicants are incorrect on both scores. As Air Canada will demonstrate below, there are powerful grounds for distinguishing the situation which faced Northwest and KLM from that surrounding American and Canadian, and there are numerous reasons why a grant of immunity to American and Canadian would do anything but enhance competition in the U.S.-Canada market.

Air Canada has two primary reasons for opposing the Joint Application: (i) Air Canada believes that it would be inappropriate to confer antitrust immunity upon alliances serving the transborder market on a discriminatory and selective basis, and especially during the pendency of the transition periods provided for in the U.S.-Canada Agreement; and (ii) approving the Joint Application would cause severe competitive distortions in the U.S.-Canada market.

Despite the foregoing, if DOT were to decide that this were an appropriate time to grant the Joint Application, DOT must be certain to place all alliances serving the transborder market on identical footing. If the Joint Application were approved, then the Department also must approve an Application that would be filed by Air Canada and a U.S. alliance partner in such a circumstance.

I. APPROVAL OF THE JOINT APPLICATION WOULD BE INCONSISTENT WITH U.S. POLICY AND WITH THE OBJECTIVES OF THE TRANSITION PERIODS OF THE 1995 U.S.-CANADA AGREEMENT

The Joint Applicants assert that a grant of antitrust immunity is required in the public interest, and that the net effect of approval of the Commercial Alliance Agreement would be procompetitive. However, there is much evidence which would demonstrate that the net effect of approval, if on a selective basis, would, if anything, be anticompetitive and contrary to the public interest. American and Canadian would be placed in an unfairly privileged position vis-à-vis competing alliances.

Although the Joint Applicants assert that their proposed arrangement would be entirely consistent with settled U.S. regulatory policy, the Joint Application should be viewed as anything but routine. As described below, there are strong grounds for distinguishing the Joint Application from other applications which have preceded it, and there are several reasons why conferring immunity upon the American-Canadian alliance would be inimical to the principles which underlie the groundbreaking agreement between Canada and the United States which was signed last year.

A. Approval of the Joint Application Would Be Inconsistent With U.S. Policy

In 1995, the United States and Canada concluded an historic Air Service Agreement that created substantial new opportunities in the transborder market for carriers of both the United States and Canada.

Although the Agreement has stimulated several new transborder services by both U.S. and Canadian carriers, the Agreement provides for the gradual "phase-in" of U.S.

carrier access to three key Canadian markets -- Toronto, Montreal and Vancouver. The limitations on new services at Montreal and Vancouver expire in 1997, and the restrictions on the introduction of new services at Toronto expire in 1998.

The "phase-in" or "transition" periods described above are the result of careful and balanced negotiations between the United States and Canada. They were put into place in order to give Canadian carriers a "head-start" in the market -- a short period of time in which to prepare for fully open competition with U.S. carriers. This "head-start" was recognized on both sides of the border as an essential component of the Agreement, because U.S. megacarriers enjoy significant structural advantages over their Canadian counterparts, including far larger fleets, well-developed "hub and spoke" systems, and a large home market. Geography, and the distribution of the Canadian population, absolutely preclude Canadian carriers from duplicating these advantages.

Although the 1995 U.S.-Canada Agreement represents a welcome giant step forward in the liberalization of the U.S.-Canada market, the Agreement cannot yet be characterized as an "Open Skies" Agreement. Once the transition periods expire, however, both U.S. and Canadian carriers will be able to serve any point in Canada from any point in the United States, without frequency or capacity restrictions.

The U.S. Government on numerous occasions has stated that an Open Skies Agreement must be in place before it will consider conferring antitrust immunity upon any commercial alliance.[1/] For example, Secretary Peña last year emphasized that:

> [M]y Department is actively considering the question of antitrust immunity -- but only where the overall net effect of a transaction for which immunity is sought is pro-competitive and pro-consumer. The existence of an "open skies" environment, and the elimination of other competitive restrictions, would be important factors in any such consideration.

Similar sentiments also have been articulated by the Department of Justice.[2/]

Although this issue should be of even greater concern to U.S. carriers than it is to Air Canada, Air Canada cannot help but observe that the Joint Application, if granted, would represent a fundamental shift in the U.S. position toward the grant of antitrust immunity. In their Joint Application, American and Canadian attempt to place themselves on the same footing as KLM and Northwest, and to sidestep the fact that the Agreement, as it now stands, would not comport with any accepted definition of "Open Skies."[3/] Instead, the Joint Applicants argue that there is very little (if any) unmet U.S. carrier desire to serve the market, and that, in the case of both Canada and the Netherlands, significant

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1/ Remarks of DOT Secretary Federico Peña before the U.S. Aerospace Industries Representatives in Europe, Paris, France, June 9, 1995.

2/ See, e.g., Roger Fones, Chief, Transportation Energy and Agriculture Section, Antitrust Division, U.S. Department of Justice, "International Code Sharing: An Antitrust Perspective," The Air and Space Lawyer, Fall 1995, at 6.

3/ By acknowledging that the U.S.-Canada Agreement as it now stands is not an "Open Skies" agreement, Air Canada does not necessarily intend to embrace the U.S. definition of "Open Skies."

bilateral liberalizations preceded the request for antitrust immunity. See, e.g., Joint Application at 24-25.

The primary concerns which underlie the U.S. policy would be undermined if the Department were to approve the Joint Application. As a threshold matter, when considering whether or not to confer antitrust immunity upon an alliance, the Department attempts to ensure that the applicable bilateral air service agreement would enable other carriers to offer new services to compete with the immunized alliance. In this context, the Department would have to find in this docket that there are no restrictions on competitive entry in the U.S.-Canada market, a finding which quite clearly cannot be made.

The second concern that has been articulated by DOT is that, because antitrust immunity can serve as a bilateral "bargaining chip," the Department generally will attempt to use the grant of immunity as a means of achieving its own aeropolitical objectives.[4/] The United States since 1992 has used antitrust immunity as a "carrot" -- i.e., a means of inducing its trading partners to enter into Open Skies agreements with the United States. By conferring antitrust immunity upon the Joint Applicants before the transition periods

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[4/] In its Order approving the antitrust immunity application of Northwest and KLM, the Department observed:

> [T]he grant of immunity should promote competition by furthering our efforts to obtain less restrictive aviation agreements . . . . We anticipate that our positive attitude and partnership in the Open Skies Accord with the Netherlands will be recognized as a strong demonstration of our commitment to Open Skies and will lead to other liberal agreements . . . .

Order 93-1-11, at 11-12.

have expired, the Department would be making that "carrot" a far less powerful inducement for other nations to sign an "Open Skies" agreement with the United States.

Of course, the Department is free to do as it wishes with respect to its Open Skies policy, and to depart from its enunciated policy of tying the grant of antitrust immunity to the existence of an Open Skies agreement, provided that it has a reasonable basis for doing so. But such a departure -- indeed, a "paradigm shift" -- should not be undertaken without a compelling, publicly-formulated rationale. See, e.g., Atchison, Topeka & Santa Fe R. Co. v. Wichita Board of Trade, 412 U.S. 800, 808 (1973).

B. Approval of the Joint Application Would Be Inconsistent With the Objectives of the Transition Periods of the U.S.-Canada Agreement

Another concern raised by the Joint Application is that, by approving the Joint Applicants' request, the Department would vitiate the purpose of the "phase-in" periods described above, over which the U.S. and Canadian Governments so painstakingly negotiated.

Air Canada wishes to emphasize that there are considerable public benefits associated with the introduction of transborder services by both itself and its competitor, Canadian. However, by conferring antitrust immunity upon the Joint Applicants, the Department would enable the Joint Applicants to consolidate their network planning functions, pool their revenues, and operate as if they were a merged carrier. Under such a scenario, American would be in a position to handpick the new markets which would be served by Canadian, and to share in the profits associated with operating those services. Therefore, by conferring antitrust immunity upon the Joint Applicants, the Department

would be permitting American to do indirectly what it cannot do directly -- participate in transborder markets to which access is temporarily restricted, and enable American to benefit from the same "head start" as that enjoyed by Canadian carriers. Such an action would dilute the value of the short-term protections for Canadian carriers upon which the new liberalized bilateral is based.

It would be inherently unfair to permit American to circumvent the transition periods, and to enjoy benefits which would be unavailable to competing alliances. Unlike their competitors, American and Canadian would be free to offer joint prices on their transborder routes, and to coordinate closely as to the services they will offer in the market. Moreover, those airlines would enjoy a significant cost advantage to the extent that they would be able to integrate their sales forces. As the Joint Applicants themselves have noted, the commercial benefits associated with the receipt of antitrust immunity are substantial. If DOT were to confer antitrust immunity only upon particular alliances, to the exclusion of other alliances, then other alliances would be deprived of the opportunity to compete with the Joint Applicants on a fair and equal basis.

The unfairness associated with bestowing a significant benefit upon only a particular commercial alliance serving the transborder market, to the exclusion of competing alliances, would be compounded by differences between the nature of the relationship between Canadian and American, and the relationships between most other alliance partners. Unlike most alliances, which are largely "arm's-length" relationships, the Canadian-American alliance is very much between a senior and junior partner. Through its significant 33% equity position in Canadian, and the circumstances under which that

investment was made,[5/] not to mention the numerous services it provides for the carrier, American exerts considerable leverage over Canadian, if not outright control. By conferring antitrust immunity upon the Joint Applicants, the Department would not only legitimize that control, but would provide the alliance with advantages that would go unmatched by any of their competitors.[6/]

II. IMMUNITY IS NOT REQUIRED TO ENABLE THE JOINT APPLICANTS TO COMPETE IN THE U.S.-CANADA MARKET

The Joint Applicants argue that they need antitrust immunity in order to remain competitive with Air Canada in the U.S.-Canada market, and to create a well-developed "hub and spoke" system on both sides of the border. See, e.g., Joint Application at 17-19. This contention is contradicted by the facts and by recent trends in the North American market.

The Joint Applicants attempt to cast Canadian in the role of an "underdog" and Air Canada as a "giant" in order to justify their demand that they receive extraordinary regulatory largesse from the DOT. A more realistic view of the North American market would demonstrate that Air Canada is anything but a "giant."

[5/] American made its investment in Canadian at a time when Canadian was in dire financial condition, which gave American considerable leverage at the time to dictate the structure of that relationship.

[6/] The commercial relationship between Air Canada and United is far different from that between the Joint Applicants. Although United is far larger than Air Canada, the Air Canada-United relationship is a mutually beneficial relationship between competitors, and not between a "senior partner" and its de facto "feeder" partner.

In order to make their arguments, the Joint Applicants dwell rather myopically on relative market shares based on transborder frequencies.[7/] When we step back a bit, and examine the market from a more reasonable distance, the view changes quite dramatically. A more objective examination of the market would reveal that both Air Canada and Canadian are quite small in comparison to their U.S. competitors.

For example, Air Canada is far smaller than any of its U.S. competitors in terms of revenues, fleet size and RPM's flown. In terms of total revenue for 1994, Air Canada ranked ninth among North American carriers, falling far behind TWA, USAir, Continental and Northwest. Canadian was eleventh on the list. Air Canada had revenues of $2.945 billion, and Canadian, $2.162 billion. By contrast, American's annual revenues for the year topped $16.1 billion.[8/]

The data concerning relative fleet sizes are consistent with this picture. As of the end of 1994, Air Canada had 103 aircraft in its fleet, and Canadian had 83. Both Canadian carriers were dwarfed by their U.S. competitors, with American having 647 aircraft in its fleet, United having 543, and Delta 542.[9/] This enormous disparity in fleet sizes quite

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[7/] Air Canada questions the validity of focusing almost exclusively on market shares. As a practical matter, in a market served by several U.S. carriers, the shares of individual carriers will, as a general matter, be relatively small. By contrast, most countries other than the United States have only one or two airlines of any size, which would give a Canadian carrier serving the market a larger market share relative to any one U.S. competitor. A view of U.S. carrier market share as a whole reveals that, as a whole, the market is balanced in favor of U.S. carriers.

[8/] Airline Business, September 1995, at 51.

[9/] Air Transport Association, "Air Transport 1995: The Annual Report of the U.S. Scheduled Airline Industry," May 1995, at 12.

naturally translated into an enormous disparity in RPM's flown, with Air Canada flying 14.995 billion and Canadian 12.872 billion RPM's in 1994. In comparison, American flew 98.735 billion RPM's during that same time period.[10/]

The claims made by the Joint Applicants are defective not only because they gloss over the relative sizes and strengths of the players, but also because they fail to examine the systemwide strengths and weaknesses of the players outside of the transborder market. For example, Canadian traditionally has emphasized its long-haul international services, and particularly its services to Asia. Moreover, it warrants mention that American has the largest domestic route network of all U.S. carriers, and a worldwide route system that encompasses more than 300 points.[11/]

Although the Joint Applicants acknowledge that the new U.S.-Canada Agreement has brought about a dramatic increase in service in the market by both U.S. and Canadian carriers (Joint Application at 28-9), they attempt to argue that they somehow are at a competitive disadvantage in the market because Air Canada offers a greater array of transborder services than does American or Canadian.[12/] As a threshold matter, the complaints of the Joint Applicants ring hollow, as they have the same opportunity under the 1995 Agreement to offer transborder services as do Air Canada and its own alliance partners. That the Joint Applicants may or may not have chosen to exploit those opportunities has no bearing on this case. Moreover, Air Canada in particular would

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[10/] Id.

[11/] See "AMR Corporation: Corporate Facts," Fall/Winter 1995, at 13-4, and 22.

[12/] See, e.g., Joint Application at 19.

question whether American would endorse the same logic if employed by its competitors in South and Central America, where American is "dominant," and the services of American far outstrip those of its rivals. The facts demonstrate that, despite any "disadvantage" that allegedly might be created by the U.S. market strength, since the 1995 Agreement entered into force, U.S. carriers have increased their service levels quite considerably. For example, Northwest grew its transborder capacity by 48.6%, and American grew its capacity by 27.5%.[13/]

The Joint Applicants attempt to argue that antitrust immunity is required for them to be able to compete in a highly competitive marketplace, and cite with dismay the fact that Air Canada responded "aggressively" to their new code-sharing arrangement on the La Guardia-Toronto route. Questioning whether they can match Air Canada's "overwhelming" market power, they assert that they need "a fully cooperative relationship, immunized from antitrust risk," to match the "threat" posed by Air Canada. See, Joint Application at 36.

The example cited by the Joint Applicants is puzzling. As of the last week of November 1995, American and Canadian combined were offering 87 frequencies in the

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13/ Official Airline Guide, November 27 to December 3, 1995 compared to November 28 to December 4, 1994, non-stops only, excluding codeshare frequencies.

Toronto-La Guardia market, as compared with Air Canada's 78, a difference of 9 frequencies in the Joint Applicants' favor.[14/] Moreover, Air Canada always has interpreted an aggressive response to the introduction of a new service by a competitor as a sign that competition is flourishing, and not as a signal that it is time for a regulatory agency to step in and change this most "undesirable" state of affairs.

Moreover, the Joint Applicants base their contention that Air Canada "dominates" the transborder market on highly selective data.[15/] For instance, the Joint Applicants assert that Air Canada's share of the transborder market is 24.8%, compared to 8.6% for American (itself the second-largest player), and 5.4% for Canadian.[16/] The Joint Applicants, however, exclude from the frequencies upon which they base their calculations services operated by the regional airline partners of American and Canadian. On its face, the Joint Applicants' Exhibit JA-2 indicates that the combined weekly, round-trip frequencies of American, Canadian, and their regional affiliates totals 555, compared to

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[14/] Official Airline Guide, North American ed., November 1995. The Joint Applicants also argue that they need antitrust immunity in order to remain competitive on the Toronto-Chicago route, because of the threat posed by the recently-approved code-sharing arrangement between United and Air Canada. Joint Application at 37. The facts are that, as of the end of November, American and Canadian combined were offering 54 weekly frequencies on that route, whereas Air Canada and United were operating 68, a 44%-56% market split. Although Air Canada would caution in any circumstance against focusing too heavily on any particular market, the evidence here demonstrates that the alliances are closely matched, casting doubt on the proposition that any regulatory intervention would be warranted.

[15/] The confidential documents submitted by the Joint Applicants paint a different picture. In those documents, the Joint Applicants

Single-page document entitled "Transborder," undated, filed by Canadian.

[16/] Joint Application at 33, and at Exhibit JA-2.

Air Canada's 755 when including its regional affiliates. Thus, the Joint Applicants' own figures show that their alliance enjoys a very close second 18.3% share of transborder frequencies, versus Air Canada's 24.8%.

Moreover, the Joint Applicants provide only a limited "snapshot" of the market, rather than looking at the evolution of the market over time. For example, the Joint Applicants base their entire analysis upon a comparison of relative traffic shares for one week in November 1995. A more thorough analysis indicates that, as the market has expanded, Air Canada's relative market share has declined over the last five years, from 27.3% in 1990, to 25.9% in 1994, undermining the notion that regulatory intervention would be needed in order to place the market in a state of "equilibrium" deemed desirable by the Joint Applicants.[17/]

III. IF THE DEPARTMENT WERE TO GRANT ANTITRUST IMMUNITY TO AMERICAN AND CANADIAN, IT MUST TREAT ALL U.S. AND CANADIAN CARRIERS IN AN EVEN-HANDED MANNER

As the above analysis of the market demonstrates, the efforts of the Joint Applicants to characterize Air Canada as a "giant" in the transborder market are entirely unpersuasive, as are their claims that DOT precedent compels approval of their request for antitrust immunity. If, however, the Department were to decide to confer immunity upon

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[17/] Stats Canada scheduled and charter traffic. In the confidential documents submitted by the Joint Applicants, the Joint Applicants on several occasions in fact acknowledge

Canadian Airlines Customer Research, "Insight Into the Transborder Market," dated July 31, 1995.

American and Canadian, then the Department must treat in a similar manner all U.S. and Canadian carriers that also might desire immunity.

Cloaking the American/Canadian alliance with antitrust immunity, while withholding it from other alliances, would create severe competitive distortions, and would be inconsistent with principles of fairness and sound regulatory policy. As the Joint Applicants themselves state, "Uniform, fair, and consistent application of regulatory policy requires the Department to accord similar antitrust immunity. . . to avoid a double standard.[18/] "

The reasons for denying or deferring the request of the Joint Applicants for antitrust immunity are legion. If, however, the Department were to abandon its settled policy and confer immunity upon the Joint Applicants, it must also confer antitrust immunity upon other U.S.-Canada transborder alliances.

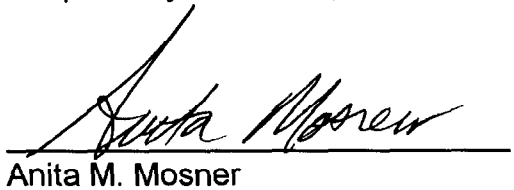
IV. CONCLUSION

The Joint Application should not be viewed as a simple "me-too" response to the Northwest/KLM alliance and the Delta/Swissair/Sabena/Austrian request for antitrust immunity. The American/Canadian alliance is different than, and should be placed on a different footing from, the other alliances which have been approved or are now under consideration by DOT.

[18/] Joint Application, at 10.

A hallmark of fair competition is the existence of a level playing field. At present, the playing field upon which Air Canada and the Joint Applicants compete is not tilted in favor of Air Canada, nor in favor of Air Canada and its alliance partners, despite the Joint Applicants' contentions to the contrary. Indeed, by conferring antitrust immunity upon the Joint Applicants, the Department would cause the playing field to tilt inexorably in the Joint Applicants' favor. The grant of antitrust immunity in this docket would be neither necessary nor appropriate. Therefore, the Joint Application should be denied.

Respectfully submitted,



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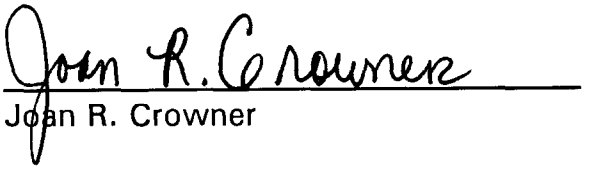

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